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Follow-up to and implementation of the outcome of the International Conference on Financing for Development

Follow-up to and implementation of the outcome of the International Conference on Financing for Development

Report of the Secretary-General**

Summary

Pursuant to General Assembly resolution 61/191, the present report provides an analytical assessment of the implementation of agreements reached at the International Conference on Financing for Development in 2002, prepared in full collaboration with the major institutional stakeholders, as an input to the High-level Dialogue on Financing for Development. Following a brief introduction, it covers all the six core areas of the Monterrey Consensus. In addition, the report reviews key intergovernmental and multi-stakeholder activities carried out in implementing the commitment to staying engaged. Each section contains policy recommendations calling for action by Member States and other stakeholders in the financing for development follow-up process.

The follow-up reports of the Secretary-General on the Monterrey Consensus have reviewed progress and setbacks in its implementation on a yearly basis, for six consecutive years. These reports paint a mixed picture: considerable advances in some areas and modest progress, stagnation or retrogression in others. While the evolution of the world economy in this period has shown general improvement, and no new significant financial crisis, such as those experienced in the late 1990s, has emerged, there are widespread concerns that the fruits of development and growth are not fairly distributed and, even more disturbing, that there seems to be a growing trend towards a higher concentration of income and wealth. The present conjuncture,

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characterized by generally favourable economic conditions, provides a unique opportunity for actions based on a long-term vision. There is ample room for launching reforms at the domestic and international levels to consolidate the foundations for widespread economic growth, sustainable development and social progress.

As in previous years, the present report should be read in conjunction with the reports of the Secretary-General on the international financial system and development, external debt crisis and development, international trade and development and the regional dimension of the implementation of the Monterrey Consensus, as well as the summary by the President of the Economic and Social Council of the special high-level meeting of the Council with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development.

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I. Introduction

1. Since the adoption of the Monterrey Consensus of the International Conference on Financing for Development,[1] macroeconomic management, and with it fiscal management, has improved markedly in the majority of developing countries. External debt indicators have also improved in most countries. There has been progress in many countries in financial sector development, in particular in promoting a more inclusive financial sector and enhanced financing for small and medium-sized enterprises. Social expenditures per capita are on the rise and the share of the poor in the total world population is receding, although not as fast as necessary to meet the Millennium Development Goals in many countries. In a number of countries, poverty is still on the increase and income and wealth distribution indices leave much to be desired.[2]

2. The flow of private resources to developing countries has grown substantially. Yet, the considerable concentration of debt-creating flows and foreign direct investment (FDI) has not changed substantially. A dozen or so developing countries still absorb 70 per cent of such flows. As in the past, FDI in several countries continues to be channelled almost exclusively to the primary commodity sector, oil in particular.

3. While private flows to developing countries are forecast to remain at comparatively high levels in the near future, there is no assurance that they will be sustained. A disorderly correction in major world economic imbalances or a sudden drop in international liquidity could lead to an abrupt stop or even reversal of such flows. Major domestic and coordinated international efforts will be necessary to avoid substantial disruptions in living standards in developing countries if the latter scenario materializes.

4. International trade has recovered from the modest growth seen in the period 1997-2001. However, new forms of protectionism have appeared and the lack of decisive progress in the World Trade Organization Doha Development Round of trade negotiations is casting a shadow on the future growth of international trade. The increasing resort to bilateral agreements is no substitute for a multilateral framework for trade.

5. Since the Monterrey Consensus, the trend of decreasing official development assistance (ODA) has been reversed. There has been a measurable increase in new resources and, until 2005, substantial amounts of debt forgiveness. Grants are on the increase. The European Union member States have set intermediate targets — and these are being met — that might lead them collectively to achieve the 0.7 per cent target. Non-European large developed country donors still remain considerably behind this target. Non-concessional multilateral flows have increased but, on net terms, they remain negative.

6. In recent years, major emphasis has been put on increasing the effectiveness of aid. Bilateral and multilateral donor coordination and harmonization have improved.

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[1] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

[2] World Institute for Development Economics Research of the United Nations University, "The world distribution of household wealth", Helsinki, December 2006.

Yet, effective ownership of programmes by recipient countries, lower transaction costs and the predictability of aid remain major challenges. The launch of the Development Cooperation Forum under the Economic and Social Council has the potential of expanding participation in and building political accountability for the effort to improve aid effectiveness.

7. While the total debt of developing countries is increasing again at a significant pace, debt indicators have improved. In the case of middle-income countries, there has been a major shift from official to private debt. This development has been facilitated by the abundance of liquidity in international markets. While it is more difficult to assess the nature and intensity of the risks under the new conditions, observers caution that in many countries vulnerability seems to be on the increase.

8. The experience from the Heavily Indebted Poor Countries Debt Initiative from 1996 demonstrates that debt relief can positively influence the development process. The Multilateral Debt Relief Initiative seeks to reduce further the external debt of heavily indebted poor countries and to provide additional resources to help them meet the Millennium Development Goals. While these efforts are significant, it is not clear if it is sufficient to put all low-income countries on a sustainable debt repayment path that will allow them to make adequate progress to reduce poverty.

9. Restructuring the international financial architecture to respond to profound changes in the global economy is an unfinished agenda. Enhanced tools for crisis prevention and resolution, strengthened multilateral consultations on various aspects of the international system, including global imbalances, and effective emergency liquidity instruments for countries with access to private markets are critical. The issue of a greater voice and increased participation of developing countries in global economic decision-making continues to be debated at the International Monetary Fund (IMF). The Committee of Experts on International Cooperation in Tax Matters was established in 2005 by the Economic and Social Council and is starting to address issues such as the definition of permanent establishment for tax purposes, exchange of information and cooperation in the collection of tax debts, combating tax evasion and the improper use of tax treaties.

10. Seven years into the twenty-first century, many voices are being raised regarding the legitimacy and effectiveness of international structures and policy approaches that still have the mark of the period immediately after the Second World War. The 2005 World Summit Outcome (General Assembly resolution 60/1), which reaffirmed the objectives, principles and policies of the Monterrey Consensus, provides critical guidelines for action at this juncture, in particular the preparations for the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, to be held in Doha in 2008.

II. Mobilizing domestic financial resources for development

11. The Monterrey Consensus highlighted the role of internal conditions for mobilizing domestic savings, both public and private, in order to sustain adequate levels of productive investment and increasing human capacity. In the past five years, understanding has increased of the elements of the internal conditions that are critical for enhancing the efficacy, coherence and consistency of macroeconomic policies. Robust and steady economic growth and an enabling regulatory

environment are indispensable in encouraging private investment, from both domestic and external sources. The Consensus assigned to each country the primary responsibility for its own economic and social development. In this regard, recent analysis has identified the potential contribution of a range of domestic policy tools, including public investment, countercyclical instruments and active employment policies.

12. Sound, growth-oriented macroeconomic policy is a necessary condition for expanding domestic resource mobilization, including promoting an enhanced role for the private sector in this endeavour. An enabling environment for private economic activity provides the basis for attracting both foreign and local investment. In this respect, Governments need to continue to improve their investment environments. Some countries have made more progress in this respect than others, especially in the area of legal and regulatory reform and improving the provision of information.

13. **Developing countries should accelerate the growth and diversity of their domestic financial sectors. Countries should pay special attention to the creation of markets for long-term debt in domestic currencies, including the issue of domestic currency bonds and a strengthened role for national development banks; facilitating the financing of productive investments, including by small and medium-sized enterprises; increased access for all segments of the population to financial services by promoting microcredit and microfinance; and establishing adequate supervision, including, as appropriate, adapting international standards and codes to domestic requirements and capabilities. Financial governance, including the quality of legal and regulatory systems, transparency, information, accounting standards and performance standards across a range of private and public institutions, is of key importance.**

14. In strengthening the enabling business environment, Governments should ensure that policies are targeted towards strengthening the foundations for entrepreneurship — especially in terms of investing in education and training, research and development and enhancement of entrepreneurial skills and traits. Technical assistance from international organizations can be very useful in this respect.

15. Only if the public sector fulfils its indispensable investment role in infrastructure and other competitiveness-enhancing activities will vigorous investment on the part of the private sector occur, since the private sector can be counted on to take risks, principally in line with sustainable enterprise and international competitiveness. However, the development of domestic financial sectors in many countries has seen the growth mainly of consumer credit and the Government debt market. It is important that domestic financial systems equally grow their credit for domestic productive activities, because financing vibrant risk-taking on the part of private actors and domestic firms in the real sector should be an important priority.

16. **There is a continuing need for technical assistance and innovative public and private partnerships to strengthen access of small and medium-sized enterprises to finance. The participation of development-oriented venture capital funds, supported as appropriate by international and national development finance institutions, needs to be scaled up. Venture capital, which**

is willing to accept higher risk and does not require collateral from borrowers, may be especially suitable in providing finance for small innovative firms in developing countries.

17. The Monterrey Consensus highlighted the role of internal conditions for mobilizing domestic savings, both public and private, for sustaining adequate levels of productive investment and increasing human capacity. In the past five years, there has been an increased understanding of those internal conditions critical for mobilizing domestic resources.[3] The 2005 World Summit Outcome recognizes that sustaining high levels of employment is an indispensable element of domestic resource mobilization. In marshalling its savings towards productive investment, the private sector's greatest obstacle is weak and unstable economic growth. Households play a key role in investing in productivity and upgraded capabilities; for them, the greatest obstacle is uncertain and vulnerable employment.

18. **National development strategies should give priority to policies that foster the progressive realization of decent work for all, thereby mobilizing resources in the fight against poverty. Emphasis on human resource development and active labour market policies, including training, are prerequisites for achieving this objective. Employment impact assessments should be part of policy design and evaluation. Countries should take advantage of the current favourable conditions to establish effective safety-net systems that will enhance the efficient functioning of their labour markets. Macroeconomic policy must play a critical role in mobilizing resources by sustaining growth and ensuring stability in domestic financial markets. In their international commitments and reform programmes undertaken in cooperation with multilateral organizations, developing countries should pay attention to enhancing their "policy space" for undertaking employment-oriented macroeconomic policy. Countries should seek to expand their tools for sound macroeconomic policy, including effective capital flow management (especially on the inflow side) and macroprudential mechanisms, the establishment of countercyclical funds, selective and targeted public spending and the enhanced use of their tax systems to manage booms and busts.**

19. The application of inflation targeting in developing countries as an approach to monetary management restored credibility to many countries that had formerly been plagued by high inflation periods. Countries with credible monetary stances have enjoyed access to more diversified sources of external finance, although counter-inflation measures have also adversely affected growth and employment.[4]

20. Inflation targets have in some cases been set too low, although moderate inflation rates seem necessary for growth. National policymakers should adopt a broad view of macroeconomic stabilization instead of focusing exclusively on inflation, which might lead to lower economic growth rates, levels of unemployment that are higher than necessary, more dependence on short-term external finance than is prudent, and highly appreciated foreign exchange rates that undermine the international competitiveness of the real sector.

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[3] *World Economic and Social Survey 2005: Financing for Development* (United Nations publication, Sales No. E.05.II.C.1).

[4] *World Economic and Social Survey 2006: Diverging Growth and Development* (United Nations publication, Sales No. E.06.II.C.1).

21. In recent years, the potential of microfinance in improving people's lives has become manifest and universally recognized. While developing microfinance mechanisms and institutions further is important, microfinance is a complement to, and cannot substitute for, the role that stable, employment-creating economic growth plays in poverty reduction. In some crisis-prone economies, microfinance in the face of increasing unemployment can lead to failing loan projects because of insufficient market demand and increased debt burdens for marginalized sectors of the population.

22. Government policies should create an environment that enables diverse financial service providers to develop a range of microfinance products that better serve the poor. Policymakers need to evaluate regulatory approaches to promote financial inclusion while respecting the fundamental regulatory objectives of financial stability and customer protection. Development assistance in microfinance should complement, and not compete with, more inclusive financial services.

23. Public investment has a critical role in development. Recent studies[5] note with concern the extended period characterized by insufficient public investment in infrastructure in many countries as a result of an overemphasis on fiscal balance and price stability. In many countries, medium-term growth prospects have been diminished as a consequence of shortfalls in infrastructure (in areas such as power, transport and telecommunications, and basic services such as water, education and health). The original confidence that the private sector would substitute totally for the public sector in infrastructure has proved to be grossly misplaced. Public investment has a critical role in development. In the same vein, there are a number of recent innovative experiences of broad social participation and incorporation of gender-responsive approaches in the formulation and monitoring of national and local budgets — some of which have been supported by the United Nations Children's Fund, the United Nations Development Fund for Women and other United Nations organizations — which have led to increased social expenditures, including a better focus on gender equality.

24. **The public sector and multilateral development banks need to remain active in financing projects at times when and in places where private investors are unable to earn sufficiently high returns and in low-income countries where the supply of private financing is low, since the bulk of the paybacks derive from the social advantages the projects create (in areas such as road construction and water provision). The public sector, especially in middle-income countries, also needs to intensify its efforts to leverage private finance by strengthening complementary services and risk-mitigation instruments. In improving the effectiveness and targeting of public expenditures, the application of tools such as gender-responsive budgeting are important.**

25. In order to have the resources to fulfil its role in terms of investment, the "fiscal space" has to be expanded. Four dimensions can expand fiscal space: improved efficiency of public expenditure, releasing resources for reallocation, efficient revenue enhancement measures including tax measures and user charges, increased access to external grant aid and new public sector borrowing.

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[5] *World Economic and Social Survey 2005* and World Bank, "Fiscal policy for growth and development: an interim report", Washington, D.C., April 2006.

26. **In taking a medium-term perspective, countries should take into account the role of growth itself (and the public sector's own indispensable role in sustaining growth) in expanding fiscal space.[3] For all developing countries, revenue enhancement — including diversifying the tax base and strengthening tax administration — is indispensable. Moreover, all developing countries should make the enhancement of the efficiency of public expenditure an important priority of their policy. Least developed countries need to bolster their capacity for increased access to external grant aid, while also seeking to improve the efficiency of public expenditure.**

27. Governments should conceive of "fiscal space" more broadly than conventionally measured fiscal solvency, a concept that does not sufficiently take into account the differential growth impact of various types of expenditure. The standard approach to fiscal solvency unduly de-emphasizes the role of public investment in promoting economic growth, which expands the tax base and enhances fiscal capability.

28. Taxation and revenues from fees and royalties remain the major instruments of domestic resource mobilization for the public sector. A robust and growing public revenue base is indispensable for protecting policy space. If countries are to cooperate meaningfully with international partners, reduce dependence on external debt and provide the permanent resource base for sustaining their Millennium Development Goals achievements, the size and buoyancy of their public revenue systems should match these commitments. Tax and revenue systems have a role in trade policy. They can also play a role in addressing the problems of rapid urbanization and environmental degradation.

29. As previously noted, in the recent period economic growth has often been accompanied by increased income inequality. While fiscal tools are often inefficient for redressing income inequality, progressive reforms of tax and tariff systems can optimize tax revenues and increase their buoyancy. In many developing countries, as a consequence of trade liberalization, unstable growth and deterioration in public sector capability, tax bases have, in fact, narrowed and become more inequitable. For example, a recent study[6] suggests that for least developed countries, only an average of 30 per cent of revenues lost through trade liberalization has been made up for through other taxes, because trade taxes tend to be easier to collect at low levels of development. Also, the taxes that have replaced those revenues have tended to be regressive, such as value added taxes.

30. **Developing countries should enhance the progressivity, diversity and stability of their tax and revenue systems. Trade liberalization programmes are meant to improve international competitiveness and should be implemented as such. The decreasing reliance on revenue sources associated with external economic activities should be carefully addressed, so that public finances grow along with trade and the economy. Public authorities should implement ways to increase their revenues from rents stemming from the exploitation of natural resources and to upgrade their governance capabilities for doing so. International cooperation and assistance, such as from the Extractive Industries Transparency Initiative, should be drawn upon.**

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[6] See Thomas Baunsgaard and Michael Keen, "Tax revenue and (or?) trade liberalization", International Monetary Fund, IMF Working Paper No. WP/05/112, Washington, D.C., June 2005.

31. The current boom in commodity prices provides an excellent opportunity to rationalize public sector revenues in the sector, including negotiating better terms in new service contracts. It is also an excellent time to upgrade governance mechanisms over these revenues. Countries should not miss this chance to properly attach their export revenues to their poverty eradication commitments.

32. **Resource-use taxes are another source for diversifying public revenues. Fees and taxes can be instruments for promoting sustainable extraction and consumption of scarce natural resources and for recovering costs to improve the quality of the environment. Both pollution abatement taxes and resource taxes can generate financing for providing expanded public services, including those that mitigate environmental problems. Within the framework of fiscal decentralization and democratic governance, local governments can play a key role in implementing these measures.**

33. Since the International Conference on Financing for Development, the prevalence of public sector medium-term frameworks has increased. The Monterrey Consensus emphasized that effective partnerships between donors and recipients start from ownership and leadership by domestic constituencies in national development planning. Ownership and leadership require the existence of a domestic capability, including active participation of all relevant actors and democratic accountability, to design, implement and evaluate appropriate development policies.

34. There is a need for developing countries to continue their efforts at institution-building and fostering the upgrading of policy capabilities and participation in different segments of society, including at the local level. In support of these efforts, the Seventh Global Forum on Reinventing Government, hosted by the Department of Economic and Social Affairs of the Secretariat, in partnership with the Government of Austria, took place at the United Nations Office at Vienna from 26 to 29 June 2007, on the theme "Building trust in government".

35. The Monterrey Consensus identified the critical role of reducing waste, improving governance, reducing corruption and simplifying, rationalizing and enhancing the enforcement of regulations and taxes. Institutions concerned with participation, transparency and accountability must go hand in hand with economic development. Growth and development release resources for the enhancement of these institutions, just as their continued improvement is indispensable for sustaining development itself. Corruption is only one aspect of the complex set of governance challenges developing countries face. The global community should more effectively cooperate to curb the existence of international corruption.

36. **Countries should carefully choose to target their resources to overcome governance weaknesses critical for accelerating and sustaining growth. All countries should ratify and implement the United Nations Convention against Corruption (General Assembly resolution 58/4, annex).**

III. Mobilizing international resources for development: foreign direct investment and other private flows

37. Over the past five years, buoyed by strong economic growth and improvements in the investment climate in a number of countries, the global flow of

private investment has grown significantly, including to developing countries. FDI inflows remain the largest single component of private resource flows to developing countries and amounted to almost $400 billion in 2006. The contrasts in the types and impacts of FDI to developing countries across different regions provide lessons on effective policy stances. For example, in Asia, foreign investors sought to participate in its dynamic manufacturing exports following successful State policies to develop sectors such as electronics. Recent FDI into Latin America has spanned a few sectors, mostly in response to privatization; while some of these investments have stimulated exports they have had limited linkages to the economy in terms of employment generation and technological upgrading. The recent global surge in investment in extractive industries globally has been particularly strong in Africa, but it remains to be seen if these investments will have significant multiplier effects on employment generation.

38. Policies to promote linkages often depend on the circumstances of the country and the need to adapt to the prevailing situation. Such policies have already been adopted in a number of countries and need to be combined with broader measures to strengthen the quality of entrepreneurship in the local economy, since a key factor in inducing foreign affiliates to form beneficial linkages depends on the availability, costs and quality of domestic suppliers and partners.

39. **The promotion of backward production linkages between foreign affiliates and domestic firms is very important. Technical assistance should be provided to help countries address market failures at different levels in the linkage formation process. In addition, measures should be employed to bring domestic suppliers and foreign affiliates together and to strengthen their linkages in the key areas of information, technology, training and finance. Broader measures to strengthen the quality of entrepreneurship — for example through training schemes — are also important.**

40. An enabling business environment is critical in order to attract and absorb stable and longer-term capital for domestic and international investment. As indicated in the previous section, some countries have made more progress in this respect than others, especially in legal and regulatory reform and in improving the provision of information. A robust domestic private sector that is itself investing in its economy provides a powerful signal to attract productive private investment inflows.

41. **Governments need to continue to improve their business environments. Multilateral and bilateral aid organizations can help in this regard by providing technical assistance to better enable countries to reform their laws and regulations, strengthen the courts, improve information, facilitate investment in infrastructure, absorb new technology and support the design of appropriate production sector developmental strategies.**

42. FDI in critical sectors of the economy such as infrastructure — both physical and social — has a potentially important role in many low- and middle-income countries. While public provision of infrastructure remains fundamental, States have sought private participation in and financing of infrastructure projects owing to the combination of rising financing needs and fiscal pressures. Improving the structure of private-public partnerships is crucial in order to avoid the kind of failures and controversies that have accompanied the recent participation of transnational

corporations in the area of provision of infrastructure and public utilities such as water.

43. Attracting the levels of FDI required to satisfy the infrastructure needs of many developing countries would depend upon addressing concerns among foreign investors relating to regulatory risk. Recent multi-stakeholder consultations on financing for development, organized by the World Economic Forum and supported by the Department of Economic and Social Affairs, have examined the issue of how development finance institutions can facilitate private investment into infrastructure sectors in developing countries. The extent to which private investors in infrastructure projects should have their risks covered is a contentious issue. It has been argued that normal market risks, including currency devaluation risk, should be borne by the private sector and only those factors beyond their control, such as regulatory risks and force majeur, should be covered by the public sector.[7] At the same time, it is crucial that Governments in developing countries do not assume risks or contingent claims that are best assumed by the private sector.

44. Through risk mitigation and capacity-building, multilateral development banks can also help broaden FDI flows to a wider range of countries, including least developed countries, land-locked developing countries and small-island developing States.[3] While the bulk of FDI still flows to a few developing countries, there are signs that this concentration has declined in recent years. This decline in concentration has been due to a sharp decline in inflows to some of the largest recipients in Latin America, a substantial increase to new recipients such as India, and rising inflows to the least developed countries and the African continent during the past few years, mainly in search of resources.

45. **There is a need for relevant multilateral, regional and national institutions to review functions and instruments that allow them to better mitigate the risks facing private foreign investors in developing country infrastructure projects. These include suggestions for mechanisms to mitigate regulatory risk, to increase the role of the World Bank and regional development banks in risk mitigation by increasing leverage for their guarantees, and to strengthen local currency lending. More generally, multilateral development banks can continue to play an important role in broadening FDI flows to the least developed countries, land-locked developing countries and small-island developing States through capacity-building and strengthening risk mitigation tools.**

46. Recently, developing countries have become increasingly important as a source of FDI. The developing country share of outward FDI flows rose from 5.5 per cent of the world total in 1990 to 14.7 per cent by 2006, reflecting the significant expansion of FDI by transnational corporations from a number of emerging economies. The recent increase in South to North investments has enhanced the diffusion of technology and strengthened incentives for developing country transnational corporations to improve their own corporate governance. Many transnational corporations from the South invest in least developed countries and the evidence suggests that the impact of South-South FDI is particularly significant for the poorest developing countries. For example, the technology and

[7] World Economic Forum, in partnership with the Department of Economic and Social Affairs of the United Nations Secretariat and the Swiss Agency for Development and Cooperation, *Building on the Monterrey Consensus: the Untapped Potential of Development Finance Institutions to Catalyse Private Investment*, Geneva, 2006.

skills of developing-country transnational corporations are often closer to those used by firms in host countries, enhancing the scope for beneficial linkages and technology absorption.

47. The rise of South-South FDI is often closely linked to extractive industries and infrastructure. Among the main factors underlying the rapid expansion and proliferation of FDI in extractive industries is the high demand for natural resources, especially arising from the energy and raw material needs of large, fast-growing emerging economies. Given the vital nature of the primary sector for many developing countries, including Africa, West Asia and Latin America, FDI in extractive industries raises a number of issues related to developmental goals. In the context of mobilizing financial resources for development, the inflow of large amounts of investment capital — as well as trade surpluses — means that for a number of developing countries a crucial new short- to medium-term issue is no longer how to mobilize capital, but rather how to utilize it more effectively in pursuit of development objectives. It is also important to note, as already indicated, that international efforts to reduce rent-seeking and prevent corrupt behaviour in these areas — such as the Extractive Industries Transparency Initiative — are gaining momentum.

48. **For the purposes of policy formulation and backstopping international cooperation, multilateral organizations should develop a greater understanding of the determinants and implications of South-South investment flows. The possibilities for supporting these flows should also be explored in the context of South-South and South-South-North triangular cooperation and collaboration among developing-country institutions. Additionally, Governments should, through appropriate policies and regulations, ensure that foreign investment in extractive industries is consistent with broader long-term development objectives**.

49. The web of international agreements of relevance to FDI has continued to expand and to function at the bilateral, regional, plurilateral and multilateral levels. Recent international investment agreements have become more complex, dealing with a broader set of issues related to the environment, trade and intellectual property protection. Moreover, within this, the role of developing countries in international investment rule-making is growing, including through more South-South cooperation. While such developments may create a more enabling framework for foreign investment, they also mean that Governments and firms have to deal with a rapidly evolving system of complex rules. The challenge is to keep this framework coherent in order to use it more effectively to achieve the development objectives of countries.[8]

50. Successful South-South cooperation — which can be found in areas such as macroeconomic cooperation, financing of investment in development-oriented activities and technical cooperation — is on the increase, and is referred to in later sections of the present report.

51. **The scaling up of South-South cooperation in strategic areas — "triangular" support from developed countries — should be explored. All**

[8] United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies — Implications for Development* (United Nations publication, Sales No. E.06.II.D.11.

stakeholders — recipient and donor countries, bilateral and multilateral development organizations, civil society and private organizations — should intensify efforts to assist South-South cooperation schemes to support national development strategies effectively and to meet national and internationally agreed development goals.

52. The overall levels of private portfolio flows to developing countries have recently been underpinned by strong global liquidity and improvements in perceived risks. Several years of benign monetary policy and an ample supply of global savings, mostly from East Asia and from oil export earnings, have combined to buoy this liquidity.[9] At the same time, the historically low levels of risk spreads are, to some degree, influenced by sound macroeconomic fundamentals in a number of developing countries — especially in relation to fiscal and external positions — and reflected in continued improvement in credit ratings.[10] These factors have resulted in low levels of financial market volatility across a broad range of assets as well as an increase and broadening of private capital flows to emerging markets, involving demand for both foreign and local currency denominated assets.[10]

53. Yet, improving fundamentals on their own may not fully explain the recent increases in asset prices in some developing countries, the reduction in spreads and the added interest payments by developing countries on their foreign borrowing. While investors are now increasingly differentiating among countries, there are concerns that they may not be giving adequate weight to downside risks. The situation can easily change in the wake of a slowdown in the global economy or a contraction in global liquidity. Another concern relates to the increasing role of hedge funds and other highly leveraged institutions and the lack of transparency and regulation surrounding their activities. Indeed, despite improved risk management techniques, there is concern that the search for higher yields has led to increased activities in markets that are less well understood and derivative instruments that may perversely increase risk in the longer-term.

54. **Hence, it is important for policymakers, at both the national and international level, to provide stronger oversight of financial market activities. As has been the experience, in particular of countries internationally perceived as successful globalizers, managing the boom periods of capital flows is critical. In this respect, countercyclical regulations and instruments should be given utmost consideration. In addition, there should also be scope for developing countries to use measures such as effective "market-based" capital regulations to curb excessive short-term capital inflows, so that long-term investors are effectively exempt from such restrictions. Finally, stronger regional cooperation and dialogue, regional economic and financial monitoring mechanisms or reserve funds and arrangements for effective currency swaps in times of crisis, can also help to reduce abrupt changes in private capital flows.**

55. Some countries have also furthered development of local currency capital markets, especially bond markets, in order to prevent over-reliance on foreign currency debt and the accompanying currency risks. However, there is growing concern that the rise of domestic indebtedness may lead to a new emerging-market

[9] World Bank, *Global Economic Prospects 2007: Managing the Next Wave of Globalization*, Washington, D.C., December 2006.

[10] International Monetary Fund, *Global Financial Stability Report, 2007: Market Development and Issues*, Washington, D.C., April 2007.

debt crisis in the medium term. Local currency bonds should not be viewed as a necessarily less risky substitute for foreign currency debt and must be monitored to maintain public debt sustainability and to anticipate the risk of pull-out by foreign investors.

56. **Regulations, mechanisms and instruments to encourage more stable capital flows need to be explored and put in place by policymakers at all levels. For example, measures can be designed to reinforce financial institutions' capital during cyclical upswings to provide increased protection during downturns, so as to constrain pro-cyclical lending strategies. Developing countries have to strike a balance between the possible increase in intermediation costs of such policies against the cost of a future system-wide crisis. Similarly, the broader adoption of countercyclical financial instruments, such as bonds linked to gross domestic product (GDP) and commodity prices, and local currency borrowing by developing countries, should also help to mitigate some risks associated with pro-cyclical international private capital flows. Perhaps most urgently, international and national authorities should collaborate to strengthen the transparency and regulation of hedge funds and derivative instruments.**

57. As mentioned above, increased transparency of financial market actors and instruments is of critical importance. In recent years, there have also been a number of initiatives to strengthen the provision of information to private investors about countries and sectors. Yet, it is important to continue to strengthen not just transparency at the national level but also mechanisms for communication between Governments and investors.

58. An increasingly important group of private investors belongs to the growing diasporas from the developing world. Diasporas have to a large degree been associated with remittances, which are the largest source of capital inflows for developing countries[11] after FDI. The contribution of diasporas extends beyond remittances and includes bond and equity finance and their ability to transfer knowledge, strengthen skills and facilitate foreign investment and trade through their networks and contacts. The activities of diaspora entrepreneurs can be distinguished from those of other international investors in terms of their motivations. Firstly, a greater degree of altruism and desires to contribute to the homeland may lead them to accept lower rates of return and greater levels of risk. Secondly, they may also be more likely to impart greater social and human capital such as transferring knowledge, encouraging reform, providing marketing networks to local firms and partners and facilitating connections and trade. Thirdly, they may have social and cultural advantages and far more specific local knowledge.

59. **Policymakers at all levels should collaborate to facilitate productive investments by diaspora communities in their countries of origin. Home countries should provide an enabling legal, regulatory and institutional environment that serves to encourage diaspora investments. Source countries should, where possible, reduce legal and funding barriers to remittances and other financial flows by migrants. More broadly, they should also encourage migrants who have shown an inclination to invest in their homeland and**

[11] World Bank, *Global Development Finance 2007: The Globalization of Corporate Finance in Developing Countries*, Washington, D.C., 2007.

provide development assistance to build capacity in diaspora networks and relevant home country institutions.

IV. International trade as an engine for development

60. The United Nations Millennium Declaration (General Assembly resolution 55/2), the Monterrey Consensus, the São Paulo Consensus, adopted by the United Nations Conference on Trade and Development (UNCTAD) at its eleventh session (TD/412, part II), the 2005 World Summit Outcome and other internationally agreed decisions have emphasized that trade, development and finance should be treated in an integrated and coherent manner to create and sustain an enabling environment for maximizing development gains for all countries, and minimizing attendant costs. At the 2007 Group of Eight Summit, major developed countries recognized that "free, transparent and open markets are fundamental to global growth, stability and sustainable development".[12]

61. An underlying premise of the Doha Development Round was the possibility of redressing the remaining imbalances in the multilateral trading system and providing developing countries with improved market opportunities, consistent with their poverty reduction goals.

62. **As an integral element of their development strategy, developing countries should integrate their public and private productive supply capacity programmes with their trade policies, in order progressively to advance value addition, sustainable employment and product diversification. In order to be able to achieve the Millennium Development Goals, most developing countries must grow significantly faster than in the past 25 years; this means that trade policies should be designed to enhance and stimulate competitive supply capacity, including through investment, especially by the private sector. At the same time, bearing primary responsibility for their own development, developing countries should carefully make their trade commitments according to their level of development and the need to retain the ability to implement the most appropriate and desired development policies. Trade opening can only be politically and economically sustainable if it is accompanied by flanking policies that address also capacity problems — human, bureaucratic or structural — and the challenges of the distribution of the benefits created by more open trade.**

63. The increased dynamism and impact of trade on the world economy and development are a central feature of globalization today. World merchandise exports of goods and services doubled between 1995 and 2005 to reach over $11 trillion. International trade and investment patterns are also inducing a rapidly changing geography in the world economy, with the emergence of a group of dynamic developing countries as significant drivers. This provides new opportunities as well as challenges for promoting fundamental development objectives and the internationally agreed development goals, including the Millennium Development Goals.

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[12] "Growth and responsibility in the world economy", Summit Declaration of the Group of Eight, Heiligendamm, Germany, 7 June 2007, para. 81.

64. Another prominent feature has been the dynamic expansion in South-South merchandise trade. The share of developing countries in world trade reached an all-time record of around 36 per cent in 2005; the share of developing countries in world merchandise imports has increased to account presently for about one third, providing new stimulus to global growth and spreading its benefits. The level of trade increased from $577 billion in 1995 to $1.7 trillion in 2005 — a three-fold increase,[13] with a concomitant increase in its share of world merchandise exports to 15 per cent in 2005. Developing countries are increasingly trading with each other — currently, about 46 per cent of developing countries' total merchandise exports went to each other, as compared with 40 per cent in 1995 — although it must be recognized that such trade is presently dominated by a few countries, driven in particular by the dynamism of trade within East Asia. This dynamism has created new challenges that need to be addressed if it is to be sustained. These include the problems associated with the lack of diversification and value addition among commodity producers, especially African countries and many least developed countries, physical infrastructure and trade facilitation (logistic) bottlenecks, limited complementarities between many countries and the marginalization and crowding out of least developed countries, as well as small and vulnerable developing economies, by larger and more competitive economies.

65. Although the performance of developing countries as a group has been impressive, many developing countries are lagging behind. For these developing countries, exports are still concentrated within a limited range of natural-resource-based products (energy and raw materials) and manufactured products (such as textile and clothing) of low value-addition and thus low (and often diminishing) returns. A significant number of these countries, most of them in Africa, have suffered from worsening terms of trade and highly volatile world prices, as well as experiencing an actual decline in their share of world trade. While other developing countries are gaining more market share, the export share of the 50 least developed countries, the majority of which are in sub-Saharan Africa and are commodity-dependent countries, fell from 2.5 per cent in 1960 to about 0.5 per cent in 1995, and has since hovered around that level.

66. Major qualitative improvements are crucial to raise the level of development benefits from trade, such as better competitiveness and supply capacity, modern infrastructure (physical and social), trade facilitation, human resource development, diversification and higher value addition of production and exports, sound financial and investment climate, technological advances, and moving to more environmentally sustainable production, consumption and trade patterns. These improvements are closely linked to the strategic goals of employment generation, food and energy security, rural development, universal access to services and poverty reduction, all of which are embodied in internationally agreed development objectives, including the Millennium Development Goals and the Monterrey Consensus.

67. The provision of services accounts for over 60 per cent of world output. While the share of services in global trade is only about 20 per cent at present, since 1980 trade in services has grown faster than trade in goods. With the advent of faster communications, transport and information technologies, the rate of growth of trade in services is expected to increase.

[13] Trade data sourced from UNCTAD's new South-South trade information system.

68. Trade in services encompasses a broad range of activities, including transportation, communications, tourism, construction, education, health, and financial and legal services. Because of their enormous potential for employment generation, export earnings and upgrading human resources, developing countries should incorporate into their national strategies, deliberate interventions for services-sector development that take into account and take advantage of comparative advantage and increased trade possibilities. Logistics services, for example, are an increasingly critical underpinning for international competitiveness in trade in goods.

69. **Bearing in mind their enormous potential for employment generation, export earnings and upgrading of human resources, developing countries should incorporate into their national strategies, specific interventions for enhancing the services sector, including increasing the potential for exports of services.**

70. The Doha Development Round of multilateral trade negotiations, launched in November 2001, still offers a unique opportunity to support development through trade liberalization, despite setbacks and suspensions. There is a real likelihood of a costly prolonged drift after 2007 if member States of the World Trade Organization do not urgently find balanced and development-oriented solutions on key issues in the main areas of the negotiations, namely agricultural market access, domestic support in agriculture, industrial tariffs and services. Texts circulated on 17 July 2007 by the chairmen of the World Trade Organization agriculture and non-agricultural market access negotiations, have recently reinvigorated consultations among member States. All countries have a shared interest in the success of the Doha Round and the realization of its core development agenda, as emphasized by the Monterrey Consensus and the 2005 World Summit Outcome.

71. **It is imperative that the needs and interests of developing countries continue to be placed at the heart of the Doha Round and its final outcome. Substantial development content with real commercial opportunities should be firmly included on a contractual basis to any final outcome of the Doha Round, including significantly enhanced and additional real market access and entry for developing countries' exports of manufactures, commodities and services in their major markets, including full provision of duty-free and quota-free treatment to all least developed countries for all their products on a lasting basis. The international community's Uruguay Round commitment to bring agricultural support programmes under the multilateral trade disciplines should be fulfilled. The Doha Round should also ensure adequate and sufficient policy autonomy that will allow developing countries to effectively manage and regulate their economic policies to achieve national development objectives. This should translate into agreed disciplines that improve special and differential treatment for developing countries and preserve the "less than full reciprocity" rule in the World Trade Organization, sustain tariff revenues, promote nascent domestic industries, pre-empt de-industrialization, protect long standing trade preferences and safeguard food security and rural development. Policy flexibility should be available to developing countries to reduce the costs of adjusting to trade liberalization and to develop the requisite productive capacities to compete internationally.**

72. As discussed in previous reports of the Secretary-General on implementation of the outcome of the International Conference on Financing for Development, aid for trade can play an important role — along with improved market access, balanced rules and sound domestic policies — in helping developing countries to realize the potential gains from trade and mitigate its potential costs.[14] The 2007 Group of Eight Summit urged all donors to improve the quality and quantity of the means available and to encourage partner countries to include the aid for trade agenda in their poverty reduction and national development strategies.[14] There is general agreement in the international community that aid for trade should trigger additional flows and that it should not provide a backdoor for new aid conditionality. The Group of Eight countries expected spending on aid for trade to increase to $4 billion by 2010, including through enhancing the Integrated Framework for Trade-related Technical Assistance to Least Developed Countries.[15]

73. **The international consensus that aid for trade should be an essential complement to trade liberalization in attaining international competitiveness and the developmental objectives of the Doha Round should be reflected in actual programmes.**

74. In parallel with the Doha Round, bilateral and regional trade agreements have proliferated worldwide to become a defining feature of today's international trade landscape. The number of regional trade agreements notified to the World Trade Organization reached 366 in October 2006, of which 214 remain in force and many more are to come. The number of operational regional trade agreements could reach 400 before 2010. The trend towards new such agreements is likely to continue on North-North, North-South and South-South bases. Unless these agreements are configured appropriately, this trend has the potential of undermining developing countries' prospects for beneficial integration into the global economy. A positive Doha outcome would limit the tendency to enter into regional trade agreements and help to ensure their compatibility with the World Trade Organization.

75. **Regional trade agreements must, at the same time, be development-oriented for their participating States, contribute positively to international economic and trade growth, and be consistent with the multilateral trading system as embodied by the World Trade Organization.**

V. Increasing international financial and technical cooperation for development

76. ODA continues to remain crucial for financing the internationally agreed development goals, including the Millennium Development Goals. As indicated in previous reports of the Secretary-General, since the Conference on International Financing for Development in 2002, when ODA had fallen to 0.2 per cent of gross national income (GNI), the declining trend of ODA has been reversed. ODA rose to $106.5 billion in 2005 or 0.33 per cent of the GNI of developed countries. However, ODA dipped in 2006 to 0.30 per cent of GNI. Despite the improvements since 2002 and commitments such as those adopted at the Group of Eight Summit held at the

[14] World Bank and IMF, Development Committee Communiqué, Singapore, 18 September 2006.

[15] "Growth and responsibility in Africa", Summit Declaration of the Group of Eight, Heiligendamm, Germany, 8 June 2007, para. 26.

Gleneagles Hotel in the United Kingdom of Great Britain and Northern Ireland in 2005, the current and projected levels of ODA for the period 2006-2010 still fall far short of targets. It is estimated that $150 billion are needed to reach the Millennium Development Goals by 2015 and, at an estimated 0.36 per cent of GNI by 2010, ODA would remain well below the 0.5 per cent achieved in the early years of initiatives under the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) and just over one half of the 0.7 per cent target.

77. As indicated above, in 2006, net ODA flows from the DAC countries declined, largely explained by the fall in debt relief. Moreover, most debt relief included as ODA, especially for Iraq and Nigeria in 2005, did not really represent additional resources for development. The inclusion of the write-off of payment arrears, which vary from country to country, means that in practice, ODA resources actually available for development have been smaller than indicated by aid statistics. In addition, aid statistics usually include emergency and technical assistance.

78. **There continues to be an urgent need to increase the overall volume of aid flows net of debt relief, technical assistance and emergency relief to meet the internationally agreed development objectives, including the Millennium Development Goals. Donor countries should meet all of their aid commitments. In the spirit of Monterrey, discussions between both donors and recipients need to be rekindled, in the new Economic and Social Council Development Cooperation Forum, on what kinds of flows should really be counted as "aid".**

79. Donor flows are volatile, and this volatility is often exacerbated by the gap between commitments and disbursements. Aid is significantly more volatile than fiscal revenue and tends to be pro-cyclical and inflexible. When aid falls, it often leads to fiscal adjustments in the form of increased taxation and spending cuts that reinforce the cyclical impact of declining aid flows. This has a detrimental impact on output and poverty reduction. Aid allocations by donors are also characterized by selectivity and uncertainty. The *World Economic and Social Survey 2005* noted that the top 20 recipients received more than half of net bilateral ODA and less than 50 per cent of aid recipients received 90 per cent of all aid from DAC donors. There are many poor low-income countries that receive very little aid and a few that have experienced surges in aid flows. The country policy and institutional assessments for allocations under the International Development Association of the World Bank, also used by many bilateral donors in aid allocations, suffer from many weaknesses that need to be re-examined.

80. **Imbalances in aid allocations need to be addressed. Discussions involving donors and recipients should examine various mechanisms donors have been using to allocate aid flows and help to identify more effective approaches. The discussions can suggest how aid delivery can be aligned to development objectives and goals and how international cooperation can promote policy advice consistent with the national development strategies — lower conditionality, simpler monitoring, reduced transaction costs, more flexibility and improved effectiveness. Broader commitments are needed to help bring about better distribution of aid flows. The selection criteria should be as transparent as possible. An effective international policy coordination framework can help ensure that needy countries are not deprived of financial assistance.**

81. Macroeconomic challenges have arisen in scaling up aid. When donors tend to move in and out of countries together, they cause surges and reversals. Aid flows can be large relative to the size of economies. Surges in aid flows can impose significant domestic costs, including large build-ups of domestic debt and rapidly increasing interest payments on total debt. In addition, an evaluation by the Independent Evaluation Office of IMF of the Fund's role in aid to sub-Saharan Africa has noted that the programmes supported by IMF under the Poverty Reduction and Growth Facility have remained strongly focused on promoting and maintaining macroeconomic stability, and that the Fund has not been proactive in helping mobilize aid resources. The evaluation found that these programmes have generally accommodated the use of incremental aid in countries with adequate reserves and low inflation. Immediate aid absorption was programmed, on average, at two thirds of the additional aid, the rest being applied to increasing international reserves in those countries with low initial reserves.

82. **Efforts are needed to design new mechanisms to ensure predictable and stable flows aligned as much as possible to a country's long-term development strategy. In order to avoid costly macroeconomic costs of dealing with surges, the periods of inflows should be stretched out in correspondence with a long-term perspective. To mitigate the volatility of donor inflows and their impact on liquidity and macroeconomic variables, offshore investment accounts could be established to absorb aid surges temporarily.**

83. While considerable multilateral and bilateral efforts are being made to assist post-conflict countries, these countries often fail to attract sufficient new financing. They usually face a wide set of problems, including security challenges, political instability, lack of capacities, precarious basic utilities and infrastructure, low growth and very low and highly volatile foreign capital flows. In fact, donors need to use specific measures to deal with these countries, which are often in arrears with international financial institutions. To address these issues, IMF designed its emergency post-conflict assistance in 1995, while the World Bank recently created a Post-Conflict Fund and a Low-Income Countries under Stress Implementation Trust Fund. In 2005, DAC set up a working group on this issue. In the United Nations, the recently established Peacebuilding Commission has also been given tasks related to various aspects of transition from conflict to laying the ground for sustainable development.

84. **Overall, re-establishing and maintaining relations with IMF are important for bilateral donors to resume their aid. Efforts should also be aimed at providing, where appropriate, budget support in the form of grants. This would help to prevent accumulation of arrears. Extensions of debt relief schemes under the Heavily Indebted Poor Countries Debt Initiative and the Multilateral Debt Relief Initiative should also be enhanced. In order to reach that stage, however, appropriate standards — supported by increased donor coordination — should be set for post-conflict countries.**

85. The current aid architecture constitutes a complex and fragmented system, which an increasing number of new donors are joining. Recipient countries have to deal with a variety of aid instruments and associated agreements with a large number of donors. The 2005 Paris Declaration on Aid Effectiveness: Ownership, Harmonization, Alignment, Results and Mutual Accountability was a milestone in setting out basic principles and launching a process around which stakeholders can

rally to address these weaknesses. OECD leadership in this area has been effective in advancing the analytical discussion of these issues and achieving the participation of DAC donors. There is increasing recognition among the parties directly involved in the Paris Declaration that, in order to accelerate progress, intensifying and regularizing the participation of developing countries in both the conceptual and operational aspects of the aid effectiveness discussion is indispensable. The new Economic and Social Council Development Cooperation Forum can play a crucial role in this regard.

86. The Paris Declaration on Aid Effectiveness embodies five principal tenets of ownership, alignment, harmonization, managing for results and mutual accountability, but progress in each area is falling short of the expectations and requirements of developing countries. For aid to be effective, each country needs to determine its own priorities, including the pace and sequencing of implementation. The principles set forth in the Paris Declaration represent a basic approach which non-DAC donors could use to guide their own actions, and the basic concepts could, in turn, guide monitoring and evaluation activities at the global level. The volume of lending by a growing number of non-DAC donors is on the increase, but the increase cannot be accurately gauged owing to a lack of standardized reporting procedures and institutions for these donors.

87. **A universal, multilateral institution, such as the United Nations, would be a natural venue for helping design and set up common procedures and reporting systems for aid flows, taking into account and building on, inter alia, DAC efforts. Similarly, a review of the performance of mechanisms such as vertical funds and trust funds is needed to evaluate their effectiveness, as they generally lack flexibility and the necessary coordination with all the relevant institutions and ministries in recipient countries. Ways and means are also needed to coordinate policy and aid delivery mechanisms, with both donor and recipient involvement, in technical assistance and capacity-building.**

88. Coherence at the national level is indispensable. Coherence is needed among finance ministries, development ministries, sectoral ministries and export credit agencies; international donor partners should encourage and support domestic coordination efforts, avoiding "ring-fencing" their projects to specific ministries and setting up separate implementation units. Modalities for measuring and monitoring aid effectiveness should involve genuine partnerships between donors and recipients, which means that these processes should avoid using donor-designed templates and indicators exclusively. Legislatures and, as appropriate, civil society groups from recipient countries should be adequately represented in the country assessment process, which should include a review of donor performance.

89. Commitment and efforts are needed to build a transparent and coherent system, building on OECD-DAC efforts at coordination and effectiveness. Efforts are needed to ensure recipient country participation and ownership in the governance structure of aid delivery and management. The Economic and Social Council Development Cooperation Forum could become the regular venue where the concepts of donor and recipient partnership — based on solidarity, effectiveness and mutual accountability — can be advanced. In the same vein, the governance structure of the International Development Association of the World Bank window needs to be reformed to include recipient countries.

90. Many countries need more help in capacity development aimed at strengthening planning, budgeting, monitoring and evaluation processes. About 40 per cent of aid flows for the Government sector use country public financial management, and more countries need performance assessment tools such as the Public Expenditure and Financial Accountability framework to reform their systems. As noted earlier, aid flows need to be aligned with long-term development strategies to achieve self-sustaining growth and employment so that countries can move away from aid dependency.

91. **The third High-level Forum on Aid Effectiveness, to be held at Accra in 2008, should not only review progress in implementation, but also look at concrete actions to accelerate and deepen it, focusing on such cross-cutting dimensions as ownership, accountability and capacity-building. The Forum should also look at both managing the scaling up of aid and building upon partnerships and frameworks to absorb aid flows. Concrete proposals to deal with all the above issues should be the subject of discussions at the Follow-up International Conference on Financing for Development, to be held in Doha in 2008, and in the preparatory activities before it, including multi-stakeholder consultations and similar mechanisms.**

92. Because of the recent proliferation of prepayments and the increased utilization of private finance by emerging market economies, net non-concessional multilateral flows have been quite small. Increasing the level of, and revising the modalities for, interaction between multilateral financing institutions and middle-income developing countries is consistent with the significantly increased role of those countries in the world economic community and the concomitant increase in their responsibilities. Middle-income countries are a growing source of finance, often serve as models for economic and political development and provide leadership for regional cooperation. These aspects were highlighted at the Intergovernmental Conference on Middle-Income Countries, held in Madrid in March 2007, and will continue to be elaborated upon in the follow-up conference to take place in El Salvador in October 2007.

93. **Multilateral finance institutions need to adapt the range of products and services that they provide in order to meet the evolving needs of their clients (both low- and middle-income countries). They must tailor their products and services to address key market failures that prevent countries from gaining access to private capital at favourable rates and managing the risks effectively. Areas of cooperation, such as those identified at the Intergovernmental Conference on Middle-Income Countries in Madrid, including expanding development finance, meeting responsibilities in providing global public goods such as health and strengthening regional initiatives, should be promoted further.**

94. Although it was very controversial just a few years ago and the funds that have so far been raised have been small, the topic of innovative sources of finance has been largely brought into the mainstream and most Member States now recognize it as an important aspect of financing for development. Useful lessons have been learned since 2002. At the 2005 World Summit, heads of State and Government recognized the value of developing innovative financing and took an interest in the ongoing international efforts. Several projects have been successfully launched since that time and discussions on this subject should thus continue to be on the

agenda of future meetings, including the Follow-up International Conference on Financing for Development in Doha. The Republic of Korea will host, on 3 and 4 September 2007, the third meeting of the Leading Group on Solidarity Levies to Fund Development, which was established in Paris in 2006 and in which 52 countries currently participate. Among the first projects to be implemented by the Group is a solidarity levy on air tickets, to which 28 countries have committed; proceeds will be used to scale up access to treatments against HIV/AIDS, tuberculosis and malaria, using the new International Drug Purchase Facility. An International Finance Facility for Immunization was also launched by seven countries in London in November 2006. An advance market commitment pilot programme was similarly launched by five Governments and the Gates Foundation in Rome on 9 February 2007, combining market-based financing tools with public interventions to provide long-term funding for the development of future vaccines.

95. It is thus encouraging that several projects have been implemented quickly and successfully and that various additional ideas are being discussed. It appears important to devote attention to developing and scaling up existing pilot projects. Proposals might also be prioritized by the volume of flows they can leverage and new types of added value they can provide. Civil society and the private sector could play a visible role in the design of projects and in monitoring the use of resources. Overall, a key challenge will be to continue building the consensus and to reinforce international cooperation in this area. The United Nations system has shown that it can be a catalyst for these approaches and an efficient instrument to discuss, obtain support for and help implement some of the initiatives.

96. **Several innovative mechanisms for finance have been proposed and should continue to be explored. These explorations should address how broad the scope of international cooperation in innovative financing, in each case, could and should be. Another issue that should be kept in mind is the appropriate balance required between international coordination and national implementation of these initiatives. As much as possible, the funds collected through innovative financing mechanisms should be pooled and disbursed through existing multilateral institutions with good track records in achieving development results, including organizations of the United Nations system. Specific multi-stakeholder task forces could also be set up by the Leading Group on Solidarity Levies to Fund Development and the group on Action Against Hunger and Poverty, or similar groupings, to study in-depth initiatives and proposals that may be ready for broader consideration and possible implementation.**

VI. External debt

97. In Monterrey, Mexico, the international community recognized the key role of orderly debt relief and debt cancellation in liberating resources for development. It called on debtors and creditors to share in the responsibility for preventing and resolving unsustainable debt situations. The efforts that have been exerted since have responded to challenges posed and, most importantly, have elicited shared lessons in improving debt management and monitoring and resolution mechanisms that should now be built upon.

98. The Heavily Indebted Poor Countries Debt Initiative involves 41 eligible countries, of which 33 are in Africa, 5 are in Latin America and the Caribbean and 3 are in Asia. Of these, 31 countries have reached their "decision points" and have begun receiving assistance under the Initiative and 22 have also reached their "completion points". In 2005, the Multilateral Debt Relief Initiative was launched to reduce further the debts of heavily indebted poor countries and provide additional resources to help them meet the Millennium Development Goals.

99. Under the combined effects of the Heavily Indebted Poor Countries Debt Initiative and Multilateral Debt Relief Initiative, the debt stock of the 31 post-decision countries will be reduced by an estimated 90 per cent, on average. Furthermore, debt service paid by the same group of countries has declined from about 19 per cent of exports one year prior to the decision point to about 6 per cent five years after the decision point. In line with a reduction in debt service payments, poverty-reducing expenditures have increased from about 7 per cent of GDP in 1999 to over 12.5 per cent in 2006. In absolute terms, poverty-reducing spending amounted to $20 billion at the end of 2006, more than five times as high as debt service payments after expected debt relief under the Heavily Indebted Poor Countries Debt Initiative.

100. In the case of middle-income countries where private debt dominates, the present approaches to private debt restructuring do not necessarily provide them with a "fresh start" after a default. Debt resolution approaches need to focus more on the end result rather than on intermediate targets. A significant number of middle-income countries — in which 41 per cent of the world's poor live — are heavily indebted and likely to face debt distress when the present global environment turns around. The debt sustainability frameworks used to analyse the debt situations in these countries, being mostly models of debt dynamics, are inadequate to properly analyse solvency issues. To inform comprehensive debt restructuring efforts, these frameworks should be supplemented by other tools suitable for analysing solvency issues.

101. The debt relief and restructuring approach for low-income countries, and its associated conditionalities, have not paid sufficient attention to basic growth requirements and the corresponding genuine expansion of policy space required to make overcoming debt distress possible. Because of this inadequate attention to the growth impact of debt-liberated resources for investment, debt sustainability frameworks tend to be quite dependent on governance and institutional variables to gauge debt carrying capacity. The present arrangement at the Paris Club of Industrial Country Creditors, which is an ad hoc machinery based on cooperation among its members but with no real formal structure, has been shown not to suffice. In addition, new donors and lenders who do not form part of the Paris Club, are becoming significant players in this arena. There is thus a need for an internationally accepted debt workout mechanism of official debt for all donors.

102. **The current conjuncture confirms the urgent need for a paradigm shift to debt restructuring approaches that achieve self-regenerating growth in debt-distressed countries, including the use of grants and the possibility of 100 per cent debt cancellation. Absent this kind of growth and the release of resources for poverty alleviation, in many countries the debt overhang will continue to be an obstacle to the achievement of the internationally agreed development goals including the Millennium Development Goals. Further, debt relief for heavily**

indebted poor countries needs to be supported in full by non-Paris-Club bilateral and commercial creditors. The international community should begin discussions on new- and post-Paris-Club approaches to debt workout, identifying more formal modalities or possible alternative institutional arrangements.

103. The structure and composition of debt, growth-enhancing effects of borrowing, expected internal and external primary balances, global financial stability and boom-bust cycles in capital flows are also key considerations. Developing countries are being encouraged to develop domestic markets for bonds denominated in local currencies, as a means not only to deepen domestic financial markets but also to help shield debtors from external exchange rate and interest rate shocks. The interface between domestic and international resource mobilization suggests that a "balance sheet approach" to sovereign asset-liability management could be useful as a means of managing public debt in many developing countries. Countries need to manage the risks posed by the structure of debt, contingent liabilities and volatility of spreads.

104. The extent to which foreign borrowing stimulates growth in countries also depends on a confluence of factors such as the savings-investment gap, the level of development of the financial sector and exchange rate policies. Countries that can mobilize a high level of domestic savings, for instance, may not need to rely on foreign savings to finance development. Financial intermediation for putting savings to productive uses is thus crucial and will depend upon the level of development of the financial sector. Countries should take the necessary steps to strengthen their domestic financial sectors prior to opening their capital accounts. Additional care also needs to be taken to ensure that debt inflows do not lead to currency appreciations that may unduly harm the competitiveness of the export sector.

105. **Debt management mechanisms and borrowing strategies in developing countries need to ensure that maturity and currency profiles are matched with assets in an appropriate asset-liability management framework; this should also be an important aspect of technical assistance in debt management.**

106. Integrating the reality of growing private debt into debt management strategies is another challenge. The size of external currency and other liabilities of the private sector, including commercial banks, are inadequately monitored; in many instances, the risk has been shifted from the public to the private sector and new crises could arise from vulnerable balance sheets of corporations.

107. On the international side, limited progress has been achieved in surmounting the incentive structure that has seen overextension of private credit to developing countries during episodes of greatly increased global liquidity. The present liquidity conditions are not expected to persist much longer; in June 2007, the yield curves shifted to the normal pattern, in which long-term interest rates are higher than short-term rates. Private actors need to take up their share of the burden of responsibility in financing for development by adequately evaluating and pricing risk, monitoring the level and diversity of their own exposure, and properly factoring in the cost of a default. The debt restructuring exercise in Argentina in 2002 demonstrated again the need for a fair, transparent and orderly process for sovereign debt restructuring.

108. **The international financial system is incomplete and insecure without a sovereign debt workout mechanism and a new effort needs to be launched in**

this regard. A code of conduct focuses on improving investor-creditor relations and needs to be further supported and improved, but may not be sufficient to bring about orderly debt restructuring. The increase of concessional and non-concessional lending, including by emerging creditors, would point to the need for work on an internationally accepted debt workout mechanism that involves all creditors. Countries thus need to agree on a set of principles for resolving potential debt crises that provide for fair burden-sharing between the public and private sectors and among debtors, creditors and investors. Countries should also expand the use of instruments, such as debt-for-equity swaps, that help to prevent debt crises and to reduce unsustainable debt levels. Multi-stakeholder consultations on this subject in the framework of the financing for development follow-up process could be revived and constitute a useful input to relevant discussions on the topic, including at the Follow-up Conference to be held in Doha in 2008.

VII. Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development

109. The Monterrey Consensus articulated the international community's shared interest in promoting the coherence, governance and consistency of the world's monetary, financial and trading systems. As indicated in the first section of the present report, in national markets legal, customary and State systems provide the necessary infrastructure for the functioning of markets and the enforcement of contracts. Global markets, to a large degree, require the same kind of institutional infrastructure; addressing systemic issues is the way the international community can renew and strengthen this infrastructure.

110. The global financial system has recently witnessed some steps towards reform and new policy approaches. There have been some efforts to improve the governance of international financial institutions, to strengthen surveillance and to develop tools for crisis prevention and response. Another important development in the international financial architecture has been further development of international standards and codes covering a broad range of fields.

111. The Monterrey Consensus called for modernizing governance of global finance institutions. The Bretton Woods institutions were founded in the aftermath of the Second World War, after which there have been profound changes in the global economy. Their chequered and sometimes controversial record and the steep decline in their engagement with middle-income countries, have raised questions about their role in the developing world. At the same time, these institutions are indispensable in many areas. Not only are these organizations and agencies significant sources of finance, their actions are indicators used by other donors and private parties engaging with developing countries. They also play a significant role in producing and vetting ideas about development strategies and remain influential arbiters of policy in developing countries. The current efforts to reform voice and participation in these institutions can enhance their effectiveness, relevance for and accountability to the users of their resources. In addition, strengthening the independence and competence of regional and global institutions would serve to

broaden governance on critical international issues, rather than maintaining overreliance on a limited set of institutions and countries.

112. In September 2006, the IMF Board of Governors adopted a resolution on quota and voice reform. The two main goals of the reform are to ensure that the distribution of quotas more adequately reflects the economic weight and role of member States in the global economy and to enhance the voice of low-income countries. After the initial step of increasing the quotas for four of the most underrepresented countries, IMF is continuing its work on a package of reforms that will include consensus on a new quota formula that would provide the basis for the second round of ad hoc quota increases, as well as the issue of basic votes, with the aim of reaching agreement by the third quarter of 2007, or at the latest by the first quarter of 2008.

113. The World Bank has also launched its own process of redressing voting weight anomalies in its governance structures. At its April 2007 meeting, the Development Committee welcomed a staff report setting out a range of options for enhancing the voice of developing and transition countries in the Bank's decision-making framework.[16] The report reviews options considered in previous Development Committee meetings, discussions at the Board of Governors and in various consultations. These options include selective capital increases, the allocation of 50 per cent of the Bank's capital to developing and transition countries, increases in basic votes, and special and double majorities.[17] The Committee also called for further consultations on Bank governance issues in order to reach a political consensus. This renewed debate on World Bank governance is, of course, welcome and timely.

114. Some relatively recently established institutions that have a critical role in standard setting also do not adequately incorporate developing country participation, the most important of which is the Financial Stability Forum. The present effort to expand the use of regulatory standards did not emerge as the result of a fully participatory process, jointly owned by all countries. Rather, standards have usually been adapted from those of industrial countries, mainly the Group of Seven, acting through bodies such as the Forum, with only a few developing countries present as observers but not active in decision-making.

115. **The international community should close ranks and make substantial progress towards governance reform in IMF and the World Bank in the next two years. At a minimum, the final outcome of the voting reallocations should result in a significant increase in the voting power of developing countries as a group. Strong and effective governance in all global institutions must be built on the basis of the accountability of their management and governing boards. Global economic decision-making should, as much as possible, be consolidated in international institutions of a universal nature — those that are part of the United Nations system — rather than in limited, ad hoc groups.**

116. Current account imbalances and exchange rates are economic variables shared among nations, and not fully determined unilaterally. If given the tools of economic

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[16] World Bank and IMF, Development Committee Communiqué, Washington, D.C., 15 April 2007.

[17] World Bank, "Options paper on voice and representation: final update report", DC2007/0009/1, Washington, D.C., April 2007.

surveillance, IMF has the potential to become the lead institution in attending to global imbalances. But the Fund's influence has not been sufficient in getting the needed policy adjustments in the systemically important economies. The Fund's effectiveness depends, in the first place, on the quality of its surveillance activities; however, in the final analysis, its effectiveness ultimately depends on each country's willingness to compromise in the interest of multilateral cooperation. It is important that surveillance activities be perceived as even-handed to avoid the perception that these are targeted at specific countries. In 2006 and 2007, hosted by IMF, the first multilateral consultation on narrowing global current account imbalances, involving China, countries where the euro is the currency, Japan, Saudi Arabia and the United States of America, showed the readiness of the parties involved to discuss policies in a multilateral setting and to undertake policy actions that would constitute a significant step towards reducing global imbalances. The implementation of the policy plans set out by the participants in those consultations will be monitored through regular surveillance by IMF.

117. It is necessary to develop specific rules to clarify how IMF will discharge its responsibilities by undertaking surveillance of fiscal, monetary, exchange rate and financial sector policies, and by clearly defining when domestic economic and financial policies can have adverse international spillover effects. In June 2007, IMF revised its 1977 "Decision on surveillance over exchange rate policies", in order to clarify these issues. With this revision, IMF added a new principle to provide further guidance to its members and to add clarity to the conduct of exchange rate surveillance — that a member "should avoid exchange rate policies that result in external instability" — clearly specifying the multilateral purpose of the activity. A reinvigorated multilateral mechanism of surveillance is required to prevent future build-ups of global imbalances that could unwind in a disorderly manner.

118. **Strengthening IMF capability in surveillance and encouraging increased participation in this effort by developing countries, including middle-income countries, and the regional coordination initiatives that they have launched are critical. Surveillance activities and mechanisms should elicit and sustain cooperative international behaviour by the world's trading countries and should thus be characterized as much as possible by even-handedness, objectivity, symmetry and equity. In the longer term, promoting world economic stability may require a comprehensive reform of the international monetary system, making it, inter alia, less dependent on the United States dollar as the dominant international reserve currency.**

119. The prevention of systemic financial crises is urgently needed. The significant role of emerging market economies in global capital flows has greatly intensified. Regional reserve pooling arrangements have been expanded. The steep growth in the volume of potentially volatile cross-border capital flows suggests that IMF's traditional methods of crisis prevention and resolution are much less potent than they used to be. Accordingly, the reserves build-up in emerging markets may be, at least partly, a symptom of their uncertainty about the future stability of the international financial system and the efficacy of existing multilateral instruments of crisis prevention. Despite some efforts, the international community has not yet succeeded in developing some broadly acceptable form of contingent liquidity instrument to provide financial support to countries with market access that may face potential capital account crises. This instrument must be predictable, flexible and substantial if it is to be viewed by potential users as an effective tool.

120. **It is important to take advantage of the current favourable environment to profoundly rethink international approaches to crisis prevention. At IMF, efforts to put in place a facility that will provide reliable and opportune access to significant resources should be brought to fruition. Greater cooperation between IMF and regional financing or reserve pooling arrangements should also be considered. Multilateralism at the regional level enhances the likelihood of identifying appropriate solutions and should reduce the burden on global institutions.**

121. Efforts to strengthen standards and codes emerged in the international agenda after the financial market crises of the late 1990s. One origin of the effort lay in the view that it was a lack of transparency and problems in the financial sector that led to misinformed judgements about economies, which resulted in herding behaviour and contagion in the private sector. A growing number of developed, developing and transition economies are implementing various internationally agreed standards and codes, including the International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II).

122. Another important issue is to ensure that standards and codes are regularly updated to keep pace with the changing global financial environment. There are concerns that the current regulatory treatment of hedge funds, leveraged buy-out activity and credit risk transfer markets may not be adequate.

123. **It is important to ensure that standards and codes are mutually consistent and, at the same time, flexible enough to be effectively applied in both advanced and less advanced financial systems. Also, with initiatives concerning standards and codes gaining global momentum, all parties concerned, including private entities, should be deeply involved in the work of international regulatory and standard-setting bodies. A broader representation in those bodies could result in a fairer, more widely accepted and truly universal regulation, which could contribute to a more stable financial system with welfare-enhancing effects for all.**

124. The new Committee of Experts on International Cooperation in Tax Matters has already completed two sessions and is, among other things, updating the United Nations Model Double Taxation Convention between Developed and Developing Countries for use by developing countries in concluding bilateral tax treaties with developed countries. The United Nations Model Convention draws on developments in the OECD Model Tax Convention on Income and on Capital and bilateral treaty practices, insofar as they are appropriate to developing country situations. The encouragement of investment into a country and trade with it (such as by avoiding double taxation) is not by itself enough to promote financing of development: an equitable tax yield from investment and trade is an important source for funding infrastructure and achieving the stability essential for continued investment and development. The work of the Committee of Experts has recognized that there are distinct conceptual and practical differences between the OECD and United Nations model tax conventions: the former tends to allocate more taxation rights to the country of residence of the investor, while the latter tends to preserve more taxation rights for the "source" or host country where the economic activity takes place.

125. There is growing recognition that international cooperation in combating tax evasion is not only indispensable in the fight against international crime and terrorism, but also that such cooperation could actually constitute an innovative source of finance for development by reducing revenue leakage. Multilateral cooperation in this area could, inter alia, address inequities in the tax treatment of

small and medium-sized enterprises, thereby enhancing private sector development. Upgrading tax design and tax administration through international cooperation is growing, with many international agencies, including OECD, assisting.

126. **In line with the existing broad mandate for enhancing international cooperation in tax matters, including with development objectives in mind, the United Nations should broaden and intensify its tax cooperation work and play a greater practical role in dealing with tax matters, including emerging issues that are not presently addressed in other organizations. Under the aegis of the follow-up process on financing for development, it would thus seem pertinent to undertake discussions exploring the potential for expanding tax cooperation activities at the multilateral level, including its institutional dimensions. In particular, working with other agencies active in the field, while retaining its strong developmental focus, the Committee of Experts on International Cooperation in Tax Matters itself could seek to enhance greater international cooperation in ongoing areas such as combating tax evasion, taxation of services and natural resource use, and tax administration.**

VIII. Staying engaged

127. The Monterrey Consensus embodies a major commitment by all stakeholders to keeping fully engaged at all levels, to ensuring proper follow-up to the implementation of agreements and commitments reached at the Conference on Financing for Development and to continuing to build bridges among development, finance and trade organizations and initiatives, within the framework of the holistic agenda of the Conference.

A. Annual meeting of the Economic and Social Council with the international financial and trade institutions and the High-level Dialogue on Financing for Development of the General Assembly

128. The tenth special high-level meeting of the Economic and Social Council with the Bretton Woods institutions, the World Trade Organization and UNCTAD was held in New York on 16 April 2007. The overall theme of the meeting was "Coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus". The following sub-themes were the focus of substantive discussions in four parallel round tables: (a) good governance at all levels; (b) voice and participation of developing countries in international economic decision-making, including the Bretton Woods institutions; (c) realizing the Doha Development Agenda: effective use of trade and investment policies; and (d) aid effectiveness and innovative financing for development. The meeting had before it a background note by the Secretary-General (E/2007/10).

129. A significant number of executive and alternate directors of the Boards of the World Bank and IMF participated in the meeting. Other participants included ministers, vice-ministers and other high-level officials in the areas of finance, foreign affairs and development cooperation, as well as senior managers of international organizations. Representatives of civil society and the business sector were also involved in the plenary meetings and round tables. The summary by the President of the Council (A/62/76-E/2007/55 and Corr.1) covers the wide range of views

expressed by participants during the meeting. In his concluding remarks, the President suggested that the 2008 spring meeting of the Council should significantly contribute to the preparation of the Follow-up Conference to be held in Doha in 2008.

130. The third High-level Dialogue of the General Assembly on Financing for Development is scheduled to take place on 22 and 23 October 2007, using the same modalities as those utilized in 2005. It is expected that the High-level Dialogue this year will constitute an important building block for the substantive preparatory process of the Follow-up Conference in Doha.

131. **Following up on its resolutions adopted in 2006 and 2007, the Economic and Social Council should consider effective ways to further enhance the impact of its special high-level meeting. To this end, the Council should, inter alia, focus at the meeting on specific issues and finalize the selection of themes and other preparations well in advance of the meeting. For its part, the General Assembly might consider it timely to decide on a fundamental strengthening of the institutional arrangements for intergovernmental follow-up of the financing for development process. It has been suggested on previous occasions that Member States could, for example, consider setting up a committee on financing for development or a similar mechanism to serve as a more dynamic and permanent forum to address issues related to the follow-up of both the Monterrey Conference and Doha Follow-up Conference. Such a committee could also serve as a continuing interface, at the intergovernmental level, with relevant bodies of the Bretton Woods institutions, the World Trade Organization and other stakeholders.**

B. Multi-stakeholder events on financing for development

132. Pursuant to General Assembly resolution 60/188, the Financing for Development Office of the Department of Economic and Social Affairs continues to organize, within its mandate, multi-stakeholder consultations, workshops, panel discussions and other events aimed at better enabling Member States to implement their commitments as agreed in the Monterrey Consensus. Detailed reports on the proceedings, findings and conclusions of these activities are available at http://www.un.org/esa/ffd/index.htm.

1. Building inclusive financial sectors for development

133. The General Assembly designated 2005 as the International Year of Microcredit to address the constraints that exclude people from full participation in the financial sector. In that context, the Department of Economic and Social Affairs and the United Nations Capital Development Fund, with the support of Switzerland and a multilateral agency group, undertook a project to analyse the obstacles to financial inclusion. A series of regional multi-stakeholder consultations was organized in the Middle East, Asia and Latin America, followed by an electronic conference and a global meeting, held in Geneva in May 2005. In the process, views of Governments, international organizations, financial institutions, the private sector and civil society were gathered during informal discussions.

134. As a result, a United Nations publication entitled *Building Inclusive Financial Sectors for Development*[18] was issued in May 2006. The publication introduces the

[18] United Nations publication, Sales No. E.06.II.A.3.

concept of inclusive finance as a continuum of financial services provided to the poor by a multiplicity of financial institutions as an integral part of the overall financial sector. While stressing a number of shared principles of inclusive finance, the publication does not provide policy prescriptions, but rather offers policy options that developing countries can adapt to specific national contexts. Following the launch of the publication, in Dakar in June 2006, the United Nations Development Programme (UNDP) and the United Nations Capital Development Fund have been committed to its wide dissemination.

135. In 2006, a United Nations Advisers Group on Inclusive Financial Sectors was established to advise the United Nations system and interested Member States on global issues related to inclusive finance. The Advisers Group is composed of 25 experts representing Governments, central banks, microfinance institutions and other financial service providers, the private sector, development agencies and academia. The United Nations Capital Development Fund acts as the Group's secretariat. The work of the Group focuses on three main areas: research and public policy; advocacy, regulatory and supervisory issues; and private sector engagement.

136. In this context, the Department of Economic and Social Affairs has initiated a multi-stakeholder project on "Regulation of microfinance: access and sustainability", which is undertaken in partnership with PlaNet Finance (an international non-governmental organization), the World Savings Banks Institute and the World Council of Credit Unions. The objective is to contribute to policymaking and development cooperation in the regulation of microfinance in developing countries, with a view to promoting prudent and sound provision of financial services to the poor while minimizing regulatory constraints to financial inclusion. Two preliminary meetings have been held, in New York in April 2007 and in Geneva in May 2007. The project will further entail comparative regional surveys to identify good practices in the regulation of microfinance, explore regulatory policy options and highlight priority areas for development cooperation. In addition, the Department will collaborate with the Advisers Group in convening three regional conferences. The outcome of the project will be presented to the Follow-up International Conference on Financing for Development in Doha.

137. **There is a practical need to bring microfinance activities under the financial sector's regulatory framework. In many countries, this framework is either underdeveloped or only partially applied. The legal, regulatory and supervisory frameworks are challenged not only to keep up with, but to lead the way for the development of inclusive finance. Yet, there are no detailed guidelines based on universal principles in this area. Many issues remain unresolved and need to be addressed in a multi-stakeholder environment. For that reason, interested Governments and other stakeholders are invited to provide substantive and financial contributions to the current project on regulation of microfinance.**

2. Rethinking the role of national development banks

138. The potential of national development banks in promoting economic and social development has been the focus of a series of multi-stakeholder consultations organized in collaboration with various national development banks, regional and multilateral development finance institutions, United Nations organizations and other interested parties from the official and private sectors. The consultative process was launched at an agenda-setting expert group meeting held in December

2005 in New York. The first regional consultation on challenges facing national development banks in Latin America was held in June 2006 in Lima, in collaboration with the Asociación Latinoamericana de Instituciones Financieras para el Desarrollo and the Corporación Financiera de Desarrollo. It was followed by a meeting in June 2006 in Paris, with a focus on Western Africa, co-organized by the Agence française de développement, KfW (the German development bank) and the European Investment Bank. The evolving role of national development banking in Southern Africa was addressed at the third regional consultation, held in November 2006 in Johannesburg, South Africa, in collaboration with the Industrial Development Corporation of South Africa and the Development Bank of Southern Africa, as well as the Association of African Development Finance Institutions and the Southern African Development Community. A meeting of experts on funding innovative development in the transition economies of Eastern Europe, convened by the Economic Commission for Europe in May 2007, dealt with the potential of national and regional development financing institutions. Forthcoming in the second half of 2007 are regional meetings for the Middle East and for Asia and the Pacific, with a final global conference to be held in 2008. The process will result in a publication on the role of national development banks as a renewed tool of development finance, which will serve as an input to the Follow-up International Conference in Doha.

139. The discussions focused on the following three groups of issues. First, the role of national development banks in filling gaps in financial market development by providing long-term financing, expanding the range of financial products for development and building inclusive financial sectors. Second, the potential of national development banks to improve the business climate by promoting and supporting small and medium-sized enterprises, acting as a catalyst for private investment and reducing the volatility of financial markets. Third, the need for capacity-building, including prudential regulation, rating and supervision, governance and management practices and measuring and monitoring results.

140. Overall, the regional meetings highlighted that national development banks have a critical role to play in promoting economic and social development. National development priorities, the market environment and client needs tend to evolve over time. Thus, national development finance institutions also need continually to adapt, adjust and improve, in order to respond effectively to changing development imperatives. Each meeting produced a separate set of conclusions, policy recommendations and action-oriented proposals, which contain both common and region-specific elements. The key common proposals include: compiling an inventory of national development banks and disseminating information on best practices and lessons learned; strengthening cooperation among national development banks, including cooperation on capacity-building; and enhancing exchange of information on national development banks between the United Nations system and regional associations of development finance institutions. To this end, it was proposed to conduct a global survey of national development finance institutions, based on a questionnaire to be circulated through regional associations, in order to update information on the profiles and activities of these institutions. This survey may include voluntary case studies of best practices and failures, as well as suggestions for further regional and interregional analysis.

141. **Governments should fully utilize the potential of national development banks and other development finance institutions in mobilizing financial**

resources for development, addressing market and State failures and developing domestic financial sectors. To this end, national development finance institutions should be encouraged to participate in the proposed global survey by responding to the questionnaire and volunteering case studies of national practices and lessons learned. The exchange of such information at the cross-regional level will be a practical contribution to enhancing global cooperation among national development banks.

3. Financing basic utilities for all

142. Multi-stakeholder consultations on this topic have been organized in cooperation with the Friedrich Ebert Foundation. The consultations explore long-term funding mechanisms and cost recovery strategies for providing water, electricity and other basic utilities to the poor. The meetings bring together experts from Governments, municipalities, utility providers, regulators, civil society, the private sector and academia in an informal and interactive setting, with a view to developing concrete and actionable proposals and initiatives. Following an agenda-setting expert group meeting held, in June 2006 in New York, two regional consultations were held, in December 2006 in Brasilia and in April 2007 in Lusaka. A third regional consultation for Asia and the Pacific, to be held towards the end of 2007, will conclude the process.

143. The first regional meeting focused on concrete initiatives aimed at extending utilities to the poor in Latin America. Experts exchanged lessons learned from various regional and national programmes, including the Brazilian "Luz para todos" ("Electricity for all") initiative, a participatory approach in Porto Alegre, Brazil, in financing water system extensions, a strategy in Buenos Aires to subsidize water for poorer households through higher charges for wealthier users and a strategy in Mexico City to improve its water networks through technological innovations. In addition, experts debated the macroeconomics of financing basic utilities for all, focusing on possible macroeconomic implications of capital inflows, financial market liberalization, exchange and interest rates, inflation and regulatory risk and appropriate monetary and fiscal policies.

144. The second regional consultation covered a wide range of experiences relevant to Africa. These included challenges faced by Zambia's largest power utility, ZESCO, in extending basic utilities to poor rural areas, the experience of the African Development Bank in devising and offering long-term financing mechanisms for water investment, efficiency improvements at the National Water and Sewerage Corporation of Uganda, as well as strategies to increase Government revenue through appropriate forms of taxation. The debate also highlighted macroeconomic challenges to be taken into account in the African context, such as ensuring absorptive capacity to deal with financial inflows and maintaining sufficient policy space for appropriate fiscal and monetary interventions.

145. **There is a great need to explore, in a multi-stakeholder setting, long-term funding mechanisms and cost recovery strategies for providing basic utilities, in particular water and electricity, to the poor in many developing countries. The background materials and reports of the multi-stakeholder consultations on "Financing basic utilities for all" contain useful information on good practices and lessons learned. Governments and other stakeholders, including utility**

providers, civil society and the private sector, should be encouraged to provide their comments on and inputs to the ongoing consultation process.

4. Strengthening the business sector and entrepreneurship in developing countries: the potential of diasporas

146. The Indus Entrepreneurs network helped to organize an expert group meeting on this topic on 5 October 2006 in New York. The participants comprised practitioners and experts from the private sector, the World Bank, regional development banks and UNCTAD, as well as Governments and academia. On 6 October 2006, an open briefing for United Nations delegates highlighted the findings of the expert-level discussions, in order to seek feedback from Member States.

147. The need for an action-based programme of further research was widely emphasized. It would need to be practically oriented and generate concrete measures to help diaspora groups, policymakers and supporting agencies to strengthen their capacity to engage in a relatively new area of public policy and activity. In that context, there was an overriding need for better information on and analysis of the underlying drivers and impact of diaspora activities. Setting up mechanisms that would allow for better exchange of experiences and ideas among different diaspora groupings was also called for. For example, further cross-regional dialogues would facilitate cross-fertilization of experiences and ideas. The Department of Economic and Social Affairs and UNDP will jointly undertake a follow-up project on this subject.

148. The Financing for Development Office of the Department of Economic and Social Affairs also participated in working group discussions on global corporate citizenship and in a forum on the "Outlook for public-private global developmental initiatives", organized by the Business Civic Leadership Center.

149. **The development community recognizes the need to develop innovative partnership models to harness resources and the capacity of the private sector to benefit national development efforts. In this context, interested Governments may wish to support the current multi-stakeholder project aimed at exploring policies that would better enable developing countries to realize the potential of their diasporas to increase employment and reduce poverty. The business sector should also be encouraged to keep actively engaged in the financing for development process at all levels.**

5. Debt, finance and emerging issues in financial integration

150. A multi-stakeholder workshop on the above theme was organized in March 2007 in London, in partnership with the Commonwealth Business Council and the Commonwealth Secretariat, with the support of Norway. The purpose of the meeting was to promote mutual understanding among various stakeholder groups on emerging issues in international finance, for both middle-income and low-income countries. The main topics of the meeting were implications of global imbalances and high oil prices for access to finance of developing countries; adequacy of international reserves; financial crisis prevention; the interface between domestic and international resource mobilization and its impact on debt sustainability and debt management; evaluation of current approaches to debt sustainability and debt restructuring; scaling up of aid flows to low-income countries; private sources of development finance; and the Bretton Woods approach to debt sustainability. A second multi-stakeholder workshop is planned to take place towards the end of 2007.

151. **There is a need to continue to explore, with the participation of all relevant stakeholders, new and emerging issues in international finance for development, including current approaches to debt sustainability and debt management. Member States may wish to encourage such informal discussions aimed at promoting mutual understanding and consensus-building in this area.**

6. South-South cooperation

152. The Executive Committee on Economic and Social Affairs of the Secretariat has adopted "South-South cooperation" as the cross-sectoral theme for its consideration in 2007, with a view to providing stronger and more coherent support by the United Nations to advance South-South cooperation. To that end, the Executive Committee draws on its advantage within the United Nations system, based on the knowledge and work of UNCTAD, the regional commissions and the UNDP Special Unit for South-South Cooperation. The Executive Committee also benefits from the expertise of its members in wide-ranging social and economic themes that address the multifaceted issues in South-South cooperation. The value added by the Executive Committee is to promote South-South cooperation across regions and to identify cross-regional lessons learned from relevant experiences. With due regard to the respective mandates and competencies of its member entities, the Executive Committee's agenda and workplan on South-South cooperation seeks to: (a) develop an institutional framework for enhancing the coordination and coherence of United Nations activities in support of South-South cooperation; (b) undertake in-depth studies on current trends and emerging issues in South-South and triangular cooperation; (c) strengthen programmes for promoting trade and investment among developing countries; (d) support efforts in regional and subregional integration for development; (e) support efforts for strengthening and streamlining of South-South and triangular development cooperation; and (f) provide technical assistance and support capacity-building.

153. **Member States may wish to consider further ways to strengthen and enhance the support of the international community for South-South cooperation and to streamline it into the financing for development follow-up process, as well as other relevant United Nations intergovernmental processes, such as the Development Cooperation Forum.**